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Document Type	Press Release	**No. Arsip**	PR.12.04/07
Title	**Bad Regional Fiscal Transfer System Has Bad Effect on Public Welfare in Regions**	**Date**	29 Nov
Sub-title		**Year**	2011
Related Event		**Author**	Yuna Farhan
Key Words	Fiscal Balance		

PRESS RELEASE

Bad Regional Fiscal Transfer System Has Bad Effect on Public Welfare in Regions

The overall aim of regional autonomy is to improve people's welfare by bringing service providers closer to local communities. But, after a decade of such autonomy, outcomes have fallen well short of expectations. And, despite two revisions of the legal framework governing regional autonomy, fiscal gaps among regions remain very high. FITRA's research has shown that the sub-national government receiving the highest per capita allocation of central government fiscal transfers gets 127 times more money than the sub-national government receiving the lowest allocation. This is happening because the "money follows function" principle is not being properly implemented. That is evident from lack of coordination between policies on sub-national government—the domain of the Minister of Home Affairs— and polices on distribution of funds to regions—the bailiwick of the Minister of Finance. It is also evident from the fact that, although 70% of government functions have been decentralized to regions, regions have been receiving just 31-34% of State spending power in the form of fiscal transfers to regions.

Mechanisms that are being used to transfer central government funds to regions but are not provided for in law have multiplied and risk undermining the entire fiscal transfers system. Among these are the so called "adjustment funds". In 2009 just three such funds existed but by 2011 there were seven of them. Among them, "infrastructure adjustment" funds are still controversial: They have been laden with political interests and have opened new doors for the "budget mafia". Moreover, 10 fields of activity funded by infrastructure adjustment funds have also received funding under the Special Allocation Fund (DAK for short).

The very set-up of the regional fiscal transfers system is currently encouraging sub-national governments to be inefficient and is giving a fillip to processes leading to the creation of new autonomous regions. Thus in 2011, 297 sub-national governments at the kabupaten (district) and city level spent more than half of their local budgets on public service costs. So, although the true purpose of the General Allocation Fund (DAU for short) is to enable sub-national governments to meet local needs, its funds are currently being almost wholly spent on meeting civil service costs. This situation arises because the "basic funding allocation" within the current DAU is designed to cover bureaucratic costs—including those associated with the creation of new autonomous regions. Regions are also unfailingly receiving less overall DAU funding than they are legally entitled to because a number of factors are drawing down the level of funds destined for the DAU. Thus, in 2011, sub-national governments received Rp 52.2 trillion less in DAU funding than they should have.

The DAK, which allocates funding to specific areas in support of national priorities, is also moving further and further away from its original purpose. National priorities funded under the DAK have risen from 7 in 2005 to 19 in 2011. DAK funding is based on a complex formula; its guidelines are published late; and its technical criteria are subject to frequent change. All of this makes the DAK susceptible to political manipulation and reduces its impact.

As for the Revenue Sharing Fund (DBH for short) the only regions that can expect to benefit from DBH revenue are those endowed with natural resources. The method used to apportion revenue shares between the center and regions under the DBH has never been convincingly explained. Nor has the pattern of apportionments varied greatly since the introduction of regional autonomy.

The issues outlined above should form a basis for revision of the law on fiscal transfers to regions to make it more responsive to regional autonomy's principal purpose: betterment of the people's welfare. On the basis of its research findings, FITRA believes that existing law could be improved in the following ways:

1. Fiscal transfers to regions must accord with the aims of decentralization. Accordingly, regions' share of State funds should be increased to at least 50%. Up to now the central government has consistently claimed that 60% of State expenditure is spent in regions. If that is so, there should be no problem making all that funding part of the system of fiscal transfers to regions. In the interests of having a well-coordinated law, the Ministers of Finance and of Home Affairs should have a united approach towards its revision. Also the House of Representatives should discuss the bill in a well coordinated way, transcending divisions between its sectoral commissions, particularly Commission XI and Commission II
2. Formulae used to allocate fiscal transfers to region should be simple, transparent and accountable. All data used in formulae for fiscal transfers to regions should be available to the public, should be able to be modeled and should be easily understood. There should also be a mechanism to accommodate complaints about the level of funds received.
3. The system of fiscal transfer to regions must be able to promote both efficient and effective allocation of funds in support of delivery the highest possible level of public services to local communities. A revised bill should be free of any provisions which encourage excessive expenditure on government bureaucracies. Instead, it should provide for incentives to be given to sub-national governments that succeed in providing "minimum standards of public services" (termed SPM). The "basic funding allocation" in

the current DAU formula should be done away with. Instead the formula should be based on per unit cost of achievement of SPMs. And the new law should preclude the establishment of fiscal transfer mechanisms other than those which it provides for.

4. The aim of the system of fiscal transfers to regions should not only be to reduce the vertical and horizontal disparities among regions but also the inequities in levels of per capita funding transferred to regions.

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29 November 2011
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